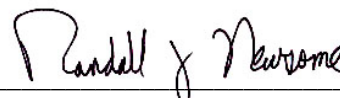




1 NOT FOR PUBLICATION

Signed: December 20, 2005

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5 RANDALL J. NEWSOME
6 U.S. Bankruptcy Judge

7
8 UNITED STATES BANKRUPTCY COURT
9 NORTHERN DISTRICT OF CALIFORNIA
10 OAKLAND DIVISION
11

12 In re:

Case Number: 03-43576RN

13 READ-RITE CORP.,

Chapter: 7

14
15 Debtor(s)/
16

17 **FINDINGS OF FACT, OPINION AND CONCLUSIONS OF LAW**

18 This chapter 7 case is before the court pursuant to Seagate Technology Holdings'¹
19 (hereafter referred to as "Holdings") election to enforce rights under 11 U.S.C. §365(n). The
20 sole issue before the court at this time is whether Holdings is a "licensee" for purposes of that
21 section. This election originally was asserted as to the chapter 7 trustee in Read-Rite's estate.
22 However, pursuant to a compromise reached with Western Digital Corporation, the purchaser of
23 virtually all of Read-Rite's assets, Western Digital agreed to serve as "attorney in fact" for the
24 trustee in this dispute.
25

26 ¹ Originally, the election was filed by "Seagate Technology LLC, for itself and as
27 successor to and for Seagate Technology, Inc., and on behalf of any of its respective Subsidiaries
28 and affiliates. . . ." Exh. 8. At the hearing on this motion, counsel for the Seagate entities
acknowledged that the election was filed as to Seagate Technology Holdings only. Tr. 12.

1 Setting forth the issue before the court is a far cry from resolving it, given the more than
2 ten years worth of baggage it drags behind it. Read-Rite was “one of the three major
3 independent suppliers of magnetic recording heads for the Hard disk drive and tape drive
4 markets.” Exh. 203. Seagate Technology, Inc. (hereafter known as Old Seagate) was a
5 manufacturer of hard disk drives², and a customer of Read-Rite. On December 31, 1994 the
6 parties entered into a cross licensing agreement (Exh. 1), whereby each party gave the other a
7 nonexclusive license to use certain patents. This relationship was not without rows, not the least
8 of which was a patent infringement action filed around 1996 by Old Seagate against Read-Rite
9 involving one of the patents included in the 1994 agreement.

10 By 1999 Old Seagate’s main asset was not its disk drive business, but instead was a 20%
11 shareholder interest in Veritas Software Corporation (hereafter Veritas), a publically traded
12 company. That 20% interest was valued at some \$10 billion, which dwarfed the value of Old
13 Seagate’s operating assets. Notwithstanding the increasing value of the Veritas holding, Old
14 Seagate’s stock price barely budged during 1999. Because of a lock-up agreement, Seagate was
15 unable to sell its Veritas stock except over an extended period of time. It could have distributed
16 the stock to Old Seagate shareholders, but it would have incurred an estimated \$6 billion in tax
17 liabilities in doing so. Instead, in late 1999 Veritas and Old Seagate initiated discussions
18 regarding a complicated transaction to unlock Old Seagate’s assets, minimize tax liabilities and
19 reward both companies’ shareholders. The essence of the deal called for Old Seagate to merge
20 into Veritas (Exh. I), and for Old Seagate’s operating assets to be acquired by means of a
21 leveraged buyout led by the private equity firm, Silver Lake Partners, and implemented in part
22 through the use of offshore corporate entities. Exh. 36, p. 19; pgs. 62-71.

23 Unfortunately, the steps transforming Seagate’s corporate structure, in much of its
24
25
26

27 ² The dispute has taken on its present hue largely because Western Digital is a direct
28 competitor of Seagate in the hard disk drive business.

1 Byzantine detail³, must be spread forth in order to comprehend the problems they caused under
2 the 1994 agreement with Read-Rite. The first steps occurred in June of 2000 with the formation
3 of a subsidiary called Seagate Technology LLC (hereafter referred to as “LLC”). Over 95% of
4 the stock in this subsidiary was owned by Old Seagate, and the remainder was owned by one of
5 Old Seagate’s wholly-owned subsidiaries, Quinta. On that same date, Old Seagate transferred all
6 of its intellectual property to LLC. Next, on August 10, 2000 Old Seagate formed a wholly-
7 owned subsidiary known as New SAC (formerly Suez Acquisition Company (Cayman) Limited).
8 New SAC in turn formed wholly-owned subsidiary Holdings, which formed wholly-owned
9 subsidiary Seagate Technology HDD Holdings (hereafter referred to as “HDD”), which formed
10 wholly-owned subsidiary Seagate Technology U.S. Holdings (hereafter referred to as “U.S.
11 Holdings”). New SAC, Holdings and HDD were incorporated in the Cayman Islands, while U.S.
12 Holdings was incorporated in Delaware. Exh. 199, pgs. 3-5.

13 The deal was fully consummated on November 22, 2000 when the following occurred:
14 Old Seagate sold New SAC to new investors and former management of Old Seagate⁴; HDD
15 purchased Old Seagate’s interest in Quinta; and U.S. Holdings purchased Old Seagate’s 95%
16 interest in LLC. Thus, Holdings (which later went public as Seagate Technology), owned the
17 assets of Old Seagate through its 100% ownership of HDD, and through HDD’s 100%
18 ownership of U.S. Holdings and Quinta. Exh. X.

19 Although Old Seagate never consulted Read-Rite regarding the effect of these changes
20 in control on the 1994 cross licensing agreement prior to the leveraged buyout, it is beyond
21

22 ³ While the Seagate side of this deal was indeed complex, the Veritas side of it apparently
23 was unheard of: “In sum, VERITAS’ role in the Rule 13e-3 transaction is highly unusual in that
24 as the “acquiror” in the merger VERITAS is a controlled rather than controlling affiliate. Indeed,
25 although the applicable definition of “affiliate” uses the term “controlled by,” we are aware of no
situation in the [SEC’s] literature or otherwise discussing a Rule 13e-3 transaction in which the
controlled affiliate takes the controlling issuer private.” Exh. 29, p. 21.

26 ⁴ The new investors, which purchased 80% of the stock in New SAC, included Silver
27 Lake Partners, Texas Pacific Group, August Capital, Chase Capital Partners and Goldman Sachs.
28 Senior management of Old Seagate purchased the other 20%. The net proceeds of the sale were
some \$1.235 billion. Exh. 36, pgs. 23-24.

1 reasonable dispute that Old Seagate was aware of the agreement's requirements and
2 implications. For example, the March 29, 2000 stock purchase agreement between Old Seagate
3 and Suez Acquisition Company (Cayman) Limited explicitly recognized the limitations on
4 assignment under Article 9 of the agreement and the need to request a new license. Exh. 18,
5 Schedule 3.6, "Cross Licenses."

6 A preponderance of the evidence also establishes that Old Seagate also understood the
7 purpose of Section 3 of the agreement, which was to limit both former subsidiaries and
8 successors by way of change in control provisions. Exh. Y, p. 3; Tr. 117. Section 3, captioned
9 "Extension of License to Subsidiaries", unambiguously sets forth specific limitations on
10 sublicensing outside of the parties' corporate families. Section 3.1 recognizes the right of both
11 parties to sublicense to a "Subsidiary". That term is defined in section 1.6 as any entity

12 "more than fifty percent (50%) of whose outstanding shares or securities. . .are, now or
13 hereafter, owned or controlled, *directly or indirectly*, by a party hereto, but such
14 corporation, company or other entity shall be deemed a Subsidiary *only so long as such
ownership or control exists*. . . . (emphasis added)

15 Exh. 1, p. 2.

16 Section 3.1 then states that

17 "[a]ny sublicense granted to a Subsidiary shall terminate on the date such subsidiary
18 ceases to be a Subsidiary."

19 Section 3.2 spells out when a subsidiary that ceases to be a subsidiary can obtain a new license.
20 First, it must obtain written approval from its former parent to seek a license from the other
21 party. Second, within 180 days of ceasing to be a subsidiary, it must submit to the other party a
22 written request for a new license. Third, the former subsidiary must be an "Operating
23 Subsidiary" as defined in Section 3.2.1 to 3.2.4. At the time it ceased to be a subsidiary, it was
24 required to have *all* of the following:

25 "3.2.1 a line of marketable products;

26 3.2.2 patents or other intellectual property relating to the line of marketable products;

27 3.2.3 tangible assets at least equivalent in value to the lesser of twenty-five million U.S.
28 dollars (\$25,000,000) or twenty percent (20%) of the total assets of the party of
which it was formerly a subsidiary; and

1 3.2.4 at the time of entry into such license agreement, it is not a corporation, company
2 or other entity who has either of the following owned or controlled by a third
3 party:

3 3.2.4.1 more than fifty percent (50%) or its outstanding shares or securities. . . ;

4 If the former subsidiary meets all of these requirements, then the other party must give it a
5 license.

6 On October 23, 2000, Old Seagate notified Read-Rite that it had assigned its rights under
7 the 1994 agreement to LLC. Exh. 2. This was followed by a January 22, 2001 letter noting
8 Read- Rite's failure to respond to Old Seagate's prior correspondence. There is no evidence that
9 Old Seagate ever sought the prior written consent for this assignment required by section 9.1 of
10 the agreement.

11 On May 18, 2001, Holdings requested by certified letter an Operating Subsidiary license
12 from Read-Rite. Exh. 4. On September 28, 2001, Edward P. Heller, Seagate's patent counsel,
13 sent a letter to Read-Rite seeking a response to the May 18, 2001 letter. Exh. 5 Prior to sending
14 the September 28 letter, Heller had a telephone conversation with a woman in Read-Rite's legal
15 department, who informed him that the company had a new legal team in place, and that they
16 would not give Seagate an answer until a review of all documents was completed. Tr. 110-11. By
17 late 2001 or early 2002, Read-Rite entertained serious doubts that Holdings was entitled to the
18 status of an "Operating Subsidiary." Tr. 165.

19 **OPINION AND CONCLUSIONS OF LAW**

20 Applying the terms of the licensing agreement to the facts outlined above, the court
21 concludes as follows: Holdings ceased to be a subsidiary of Old Seagate as of November 22,
22 2000. On May 18, 2001, 177 days after ceasing to be a subsidiary, Holdings requested a license
23 from Read-Rite, and thus met the second requirement of section 3.2 of the agreement. However,
24 Holdings has not produced a document evidencing written approval from Old Seagate to make
25 this request as required by the first part of section 3.2. More importantly, it is undisputed that
26 Holdings did not have a line of marketable products as required by section 3.2.1. All it held was
27 100% of the stock of HDD, which was probably worth more than \$25,000,000, and thus
28 arguably met section 3.2.3. But Holdings is 100% owned by New SAC, which violates section

1 3.2.4.

2 Thus, based on a straight-forward application of the cross licensing agreement's
3 unambiguous language, Holdings is not and cannot be a "licensee" for purposes of § 365(n).
4 Holdings challenges this result on a number of grounds. Initially, it attempts to argue that the
5 court should collapse the intricate corporate structure that effectuated the leveraged buyout,
6 ignore corporate and contractual formalities, and hold that Seagate was all one big company and
7 that Holdings really did meet the "Operating Subsidiary" requirements of the licensing
8 agreement through its indirect ownership of other subsidiaries. If the parties intended that a
9 former subsidiary might indirectly own a marketable line of products, they certainly knew how
10 to say so. Although a "Subsidiary" is defined in section 1.6.1 of the agreement as being more
11 than 50% owned or controlled "directly or indirectly" by a party, that language is not present in
12 section 3.2. Given the parties' intention to limit access to their intellectual property upon a
13 change in control, it would have been incongruous for a shell holding company such as Holdings
14 to qualify as an "Operating Subsidiary," particularly a shell that is wholly owned and controlled
15 by another entity. In essence, Holdings invites the court to rewrite the agreement to coincide
16 with the realities of the Seagate leveraged buyout, rather than enforcing the agreement as it is
17 written. The invitation is declined.

18 Holdings then asserts that the plain meaning of the agreement would cause it to suffer a
19 forfeiture, a result disfavored under California law.⁵ As was noted in *Milenbach v. C.I.R.*, 318
20 F.3d 924, 936-37 (9th Cir. 2003),

21 [u]nder California law, the mutual intention of the parties at the time the contract
22

23 ⁵ Although the assignability of patent licenses is governed by federal law, state law
24 applies to the construction of a patent license except where it is inconsistent with federal patent
25 policy. *In re CFLC, Inc.*, 89 F.3d 673, 677 (9th Cir. 1996). The *CFLC* court cited, among other
26 cases, *Power Lift, Inc. v. Weatherford Nipple-Up Systems, Inc.*, 871 F.2d 1082 (Fed. Cir. 1989)
27 in support of this proposition. That case holds that Oklahoma law ". . . dealing only with
28 forfeiture of contract rights. . . neither conflicts nor obstructs the patent statute." *Id.* at 1085-86.
Although Western Digital objects to applying California forfeiture law to the cross licensing
agreement, it suggests no reason why the rule in *Power Lift, Inc.* should not apply with equal
force here.

1 is formed governs interpretation of the contract. . . .Such intent is to be inferred, if
2 possible, solely from the written provisions of the contract. . . .Forfeitures are not
3 favored, however, and courts must strictly construe forfeiture provisions against
4 the party on whose behalf they are invoked. . . .Where there are two possible
5 interpretations of a contract, one that leads to a forfeiture and one that avoids it,
6 California law requires adoption of the interpretation that avoids forfeiture, if at
7 all possible.
8 [citations omitted]

9 While California courts have defined forfeiture in rather sweeping terms, it is not at all
10 clear that the doctrine applies here. Because Holdings was not even distantly affiliated with Old
11 Seagate as of November 22, 2000, it is doubtful that it has any right to invoke forfeiture as a
12 remedy. *See American Bankers Mortg. Corp. v. Federal Home Loan Mortg. Corp.*, 75 F.3d 1401,
13 1414 (9th Cir. 1996), *cert. denied*, 519 U.S. 812 (1996)(Cal. Civil Code § 3275, which deals
14 with relief from forfeitures, applies only to the parties to the obligation). In addition, there is
15 nothing in the contract that can be characterized as a forfeiture clause, i.e. a clause whereby a
16 party forfeits a sum of money or property for breach of a duty or misconduct. *Kuhlemeier v.*
17 *Lack*, 50 Cal.App.2d 802, 808 (1942). Rather, all of the evidence establishes that the agreement
18 was structured to limit the transferability of the license where a party underwent a change in
19 control. Change in control is hardly comparable to the breach of a duty or misconduct. Like the
20 option to terminate the lease involved in *Kuhlmeier*, the change in control provisions found in
21 section 3 of the agreement were part of the consideration given by each party in exchange for
22 the right to use the other's patents. The termination of the patent license for failure to meet the
23 requirements of section 3.2 was not a forfeiture, because it did not arise out of a breach of duty
24 or misconduct.

25 Even if the operation of the license agreement amounted to a forfeiture, Holdings has
26 failed to establish that it is entitled to relief from it. Initially, it must be noted that this is not the
27 sort of situation contemplated by Cal. Civil Code § 1442, which mandates that a forfeiture
28 provision "be strictly interpreted against the party for whose benefit it is created." The change
in control provisions are applicable to both parties to the agreement, not just Holdings. The
parties negotiated those provisions at arms length and with full knowledge of their import. The
pertinent language involved is unambiguous and the parties' intention is clear. If a contract has

1 only one reasonable construction, it must be enforced according to its terms. Even if a forfeiture
2 results, “this does not mean that the courts may make for the parties a different contract from
3 what they agreed upon or resort to a strained and unnatural construction to defeat or nullify their
4 clearly expressed purpose or intention.” *Troughton v. Eakle*, 58 Cal.App. 161, 173 (1922).
5 Furthermore, “[n]o artificial distinctions are to be taken advantage of or quibbling indulged in to
6 the end that a person plainly and palpably coming within the scope of the forfeiture clause may
7 by ‘some hook or crook’ escape the penalty of forfeiture.” *Kitchen v. Ballard*, 192 Cal. 384, 390
8 (1923); *quoted in Urban Properties Corp. v. Benson*, 116 F.2d 321 (9th Cir. 1940). The court
9 therefore finds that the provisions in section 3 of the agreement must be enforced according to
10 their terms, even if Holdings suffers a forfeiture as a result.

11 Holdings next argues that even if it did not comply with the requirements of the cross
12 license, it is entitled to an implied license under the federal patent law doctrine of equitable
13 estoppel. To prevail on this theory, Holdings must establish the following:

14 (1) the patentee, through statements or conduct, gave an affirmative grant of consent or
15 permission to make, use, or sell to the alleged infringer; (2) the alleged infringer relied on
16 that statement or conduct; and (3) the alleged infringer would, therefore, be materially
17 prejudiced if the patentee is allowed to proceed with its claim. . . .The first element
18 requires the patentee to communicate that “the accused infringer will not be disturbed by
19 the plaintiff patentee in the activities in which the former is *currently* engaged. . . .” Thus,
20 for this form of estoppel, the alleged infringer must have knowledge of the patentee and
21 its patent and must reasonably infer that the patentee acquiesced to the alleged infringing
22 activity for some time.
23 [citations omitted]

24 *Winbond Electronics Corp. v. International Trade Commission*, 262 F.3d 1363 (Fed. Cir. 2001).
25 Boiled down to its essence, Holdings’ implied license claim is premised on four rather
26 perfunctory letters. Given the explicit provisions of the license agreement, no one could
27 reasonably have concluded that based upon the failure to respond to these communications,
28 Read- Rite had given its consent to a patent license to Holdings. Indeed, the delay in submitting
the request, and then the nearly seven month delay in following up on it, indicates not that
Holdings was actively seeking to comply with the agreement or pin down Read-Rite’s intentions,
but rather that it wasn’t particularly concerned about the issue one way or the other.

Nor is it plausible for Holdings to claim that it relied on Read-Rite’s failure to respond to

1 its inquiries. “Misleading action by the patentee may be silence, if such silence is accompanied
2 by some other factor indicating that the silence was sufficiently misleading to amount to bad
3 faith.” *ABB Robotics v. GMFanuc Robotics Corp.*, 52 F.3d 1062 (Fed. Cir. 1995). There was
4 nothing misleading about Read-Rite’s silence, and there is not a hint of bad faith in Read-Rite’s
5 conduct. Holdings was informed in a telephone conversation prior to September 28, 2001 that
6 the matter was under review. According to Colin Campbell, who became assistant general
7 counsel at Read-Rite in March of 2001, Read-Rite was reluctant to question Seagate’s
8 compliance with the cross licensing agreement, because it wished to maintain the company as a
9 customer. Tr. 167. But after asking for missing documents that would

10 establish compliance and receiving none, Read-Rite concluded after further investigation that
11 Holdings had not complied with the agreement and thus was infringing on its patents. Exh. 6.

12 While this sequence of events does not even begin to establish the prerequisites for an
13 implied license by equitable estoppel, Holdings should not be permitted to rely on this doctrine
14 in any event. As was noted in *Stickle v. Heublein, Inc.*, 716 F.2d 1550, 1559 (Fed Cir. 1983):

15 One common thread in cases in which equitable estoppel applies is that the
16 actor committed himself to act, and indeed acted, as a direct consequence of
17 another’s conduct. . . . Thus, an implied license cannot arise out of the unilateral
expectations or even reasonable hopes of one party. One must have been led to
take action by the conduct of the other party.

18 Neither Holdings nor any of the present or former iterations of Seagate is in a position to suggest
19 that Read-Rite’s conduct caused their present predicament. The assignment of the license and the
20 structure of the new company were already a fait accompli when they sought Read Rite’s
21 approval. Obviously, they were relying on “unilateral expectations” or at most, “reasonable
22 hopes” that Read Rite’s approval would be forthcoming, notwithstanding their failure to meet the
23 requirements under the cross licensing agreement. Read-Rite’s conduct played no part in
24 Seagate’s actions.

25 Holdings waiver argument can fair no better. Under California law,

26 [w]aiver requires an existing right, benefit, or advantage, actual or constructive
27 knowledge of the right’s existence, and either an actual intention to relinquish it
28 or conduct so inconsistent with any intent to enforce the right as to induce a
reasonable belief that it has been relinquished. . . . The waiver of a legal right
cannot be established without a clear showing of intent to give up such right. . .

1 .”The burden is on the party claiming the waiver to prove it by clear and
2 convincing evidence that “”does not leave the matter doubtful or uncertain.””
[citations omitted]

3 *Utility Audit Company v. City of Los Angeles*, 112 Cal.App.4th 950, 959 (2003).

4 There is absolutely no evidence, let alone clear and convincing evidence, that Read-Rite
5 intended to give up its right to enforce the terms of the cross licensing agreement when it failed
6 to respond to Holdings’ letters; nor could Holdings have reasonably interpreted Read-Rite’s
7 silence as a relinquishment of its right.

8 For the reasons stated above, the court finds and concludes that Holdings is not a
9 “licensee” for purposes of 11 U.S.C. § 365(n), and accordingly Western Digital’s objection to
10 Holdings election under that section is sustained.

11 **IT IS SO ORDERED.**

12 *****END OF ORDER*****

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